

CHINA EDUCATION ALLIANCE INC.
Form 10-Q
August 14, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number: **001-34386**

CHINA EDUCATION ALLIANCE, INC.

(Exact name of Company as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-2012361

(I.R.S. Employer Identification No.)

58 Heng Shan Road, Kun Lun Shopping Mall
Harbin, People's Republic of China **150090**
(Address of principal executive offices) (Zip Code)

86-451-8233-5794
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

As of August 13, 2015, there were 10,582,530 shares of \$0.001 par value common stock issued and outstanding.

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CHINA EDUCATION ALLIANCE, INC.

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PART I – FINANCIAL INFORMATION**Item 1. Financial Statements****China Education Alliance, Inc. and Subsidiaries****Consolidated Balance Sheets**

	June 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	\$9,822,981	\$ 22,696,126
Accounts receivable	22,901	22,763
Other receivables	364,949	464,550
Prepaid expenses and other current assets	423,929	594,390
Total current assets	10,634,760	23,777,829
Non-current Assets		
Property and equipment, net	5,205,746	6,555,511
Intangibles and capitalized software, net	180,024	961,839
Total non-current assets	5,385,770	7,517,350
Total Assets	\$ 16,020,530	\$ 31,295,179
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$429,184	\$ 468,098
Deferred revenue	1,334,560	1,319,962
Income tax and other taxes payable	210,199	210,582
Total current liabilities	1,973,943	1,998,642
Commitments and Contingent Liabilities	-	-
Stockholders' Equity		
Common stock (\$0.001 par value, 150,000,000 shares authorized, 10,582,530 and 10,582,530 issued as of June 30, 2015 and December 31, 2014, respectively; 137,512 and 137,512 shares held in treasury, as of June 30, 2015 and December 31, 2014,	10,583	10,583

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respectively)

Additional paid-in capital	40,942,009	40,942,009
Statutory reserve	3,792,161	3,792,161
Retained earnings	(40,908,546)	(25,859,244)
Accumulated other comprehensive income	12,524,752	12,338,272
Less: Treasury stock	(977,072)	(977,072)
Stockholders' equity - CEAI and Subsidiaries	15,383,887	30,246,709
Noncontrolling interests in subsidiaries	(1,337,300)	(950,172)
Total stockholders' equity	14,046,587	29,296,537
Total Liabilities and Stockholders' Equity	\$ 16,020,530	\$ 31,295,179

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries

Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenue				
Online education revenue	\$ 85,199	\$ 130,383	\$ 168,979	\$ 257,647
Training center revenue	101,592	459,155	207,461	1,056,585
Total revenue	186,791	589,538	376,440	1,314,232
Cost of Revenue				
Online education costs	1,042,140	1,072,595	2,109,214	2,107,464
Training center costs	156,521	377,479	279,778	775,004
Total cost of revenue	1,198,661	1,450,074	2,388,992	2,882,468
Gross Profit/(Loss)				
Online education gross loss	(956,941)	(942,212)	(1,940,235)	(1,849,817)
Training center gross profit/(loss)	(54,929)	81,676	(72,317)	281,581
Total gross loss	(1,011,870)	(860,536)	(2,012,552)	(1,568,236)
Operating Expenses				
Selling expenses	884,813	1,185,254	1,777,003	2,395,702
Administrative expenses	5,096,159	5,001,944	10,264,123	8,704,791
Depreciation and amortization	304,909	523,968	749,625	1,016,164
Total operating expenses	6,285,881	6,711,166	12,790,751	12,116,657
Loss from operations	(7,297,751)	(7,571,702)	(14,803,303)	(13,684,893)
Other Income (Expense)				
Other income(expenses), net	(830)	9,967	(241)	38,023
Loss on disposal of property and equipment	(21,109)	(10,709)	(31,245)	(16,162)
Impairment loss on intangible assets	(625,922)	-	(625,922)	-
Interest income	12,459	42,284	29,936	87,870
Total other income/(expense), net	(635,402)	41,542	(627,472)	109,731
Net Loss Before Provision for Income Tax	(7,933,153)	(7,530,160)	(15,430,775)	(13,575,162)
Income taxes:				
Current	-	-	-	-
Deferred	-	-	-	-
Net Loss	(7,933,153)	(7,530,160)	(15,430,775)	(13,575,162)
Net Loss attributable to the noncontrolling interests	(326,805)	(138,388)	(381,473)	(206,325)

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Net Loss - attributable to CEAI and Subsidiaries	\$ (7,606,348)	\$ (7,391,772)	\$ (15,049,302)	\$ (13,368,837)
Net Loss per common stock-basic and diluted	\$ (0.72)	\$ (0.70)	\$ (1.42)	\$ (1.26)
Weighted Average Shares Outstanding-basic and diluted	10,582,530	10,582,530	10,582,530	10,582,530
The Components of Other Comprehensive Income				
Net Loss	\$ (7,606,348)	\$ (7,391,772)	\$ (15,049,302)	\$ (13,368,837)
Foreign currency translation adjustment	109,653	60,654	186,480	(451,437)
Comprehensive Loss	\$ (7,496,695)	\$ (7,331,118)	\$ (14,862,822)	\$ (13,820,274)

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries**Consolidated Statements of Cash Flows****(Unaudited)**

	Six Months ended June 30,	
	2015	2014
Cash flows from operating activities		
Net loss	\$(15,430,775)	\$(13,575,162)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization - operating expenses	749,624	1,016,164
Depreciation and amortization - cost of revenue	761,208	875,902
Loss on disposal of fixed assets	31,245	16,162
Impairment loss on intangible assets	625,922	-
Net changes in operating assets and liabilities		
Accounts receivable	1	(22,586)
Prepaid expenses and other receivables	272,702	(300,171)
Accounts payable and accrued liabilities	(40,819)	(631,355)
Income tax and other taxes payable	(383)	106,848
Deferred revenue	6,470	322,784
Net cash used in operating activities	(13,024,805)	(12,191,414)
Cash flows from investing activities		
Purchases of property and equipment	-	(1,205,116)
Proceeds from disposal of property and equipment	10,087	2,602
Net cash (used in) provided by investing activities	10,087	(1,202,514)
Cash flows from financing activities		
Net cash used in financing activities	-	-
Effect of exchange rate changes on cash	141,573	(393,951)
Net decrease in cash and cash equivalents	(12,873,145)	(13,787,879)
Cash and cash equivalents at beginning of period	22,696,126	56,377,154
Cash and cash equivalents at end of period	\$9,822,981	\$42,589,275
Supplemental disclosure of cash flow information		
Income tax paid	\$-	\$-

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

1. Description of Business

Nature of organization - China Education Alliance, Inc. (the “Company”), formerly known as ABC Realty Co., was organized under the laws of the State of North Carolina on December 2, 1996. ABC Realty Co.’s primary purpose was to act as a broker or agent in residential real estate transactions. On September 15, 2004, ABC Realty Co., pursuant to a Plan of Exchange, acquired Harbin Zhong He Li Da Education Technology, Inc. (“ZHL D”), a corporation formed on August 9, 2004 in the City of Harbin in the Heilongjiang Province, People’s Republic of China (the “PRC”), with an authorized capital of \$60,386 (Renminbi (“RMB”) 500,000).

On September 15, 2004, ABC Realty Co. entered into a Plan of Exchange with ZHL D and Duane C. Bennett, the former Chairman of ABC Realty Co., pursuant to which the shareholders of ZHL D exchanged all of their registered capital of \$60,386 for 18,333,334 shares of common stock of the Company, or approximately 95% of the Company’s then issued and outstanding common stock. On November 17, 2004, the Company changed its name to China Education Alliance, Inc. On December 13, 2004, the Company consummated the Plan of Exchange with ZHL D and ZHL D’s shareholders. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a recapitalization of ZHL D.

ZHL D is a technology company engaged in the online education industry in the PRC. Its mission is to promote online exam preparation services in the PRC, to improve the efficiency and effectiveness of elementary education, secondary education, vocational education, skill education, continuing education, and professional training programs, and to integrate with the international education system.

ZHL D’s subsidiary, Heilongjiang Zhonghe Education Training Center (“ZHTC”) was registered in the PRC on July 8, 2005 with a registered capital of RMB0.5 million (approximately \$60,788) and is accounted for as a wholly owned subsidiary of ZHL D. ZHL D owns 99% of ZHTC with 1% held in trust by Mr. Xiqun Yu, the Company’s CEO, for the benefit of ZHL D. In December 2013, ZHTC increased its share capital to RMB1 million (approximately \$142,412).

ZHL D also owns 70% of the equity interests of Beijing Hua Yu HuiZhong Technology Development Co., Ltd. (“BHYHZ”). BHYHZ was formed on September 30, 2006 in the PRC. At the time of its organization, we transferred a 30% interest in this subsidiary to the National Vocational Education Association of China, a non-profit, quasi-government entity, for no consideration to enable us to work with the Association’s network to expand our business.

On January 4, 2009, ZHLD entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. ("ZHLDBJ"). ZHLD contributed RMB425,000 (approximately \$62,107), and Mr. Guang Li contributed RMB 75,000 (approximately \$10,960) towards the registered capital of ZHLDBJ, amounting to a total registered capital of RMB500,000 (approximately \$73,067). In return for their respective contributions, ZHLD owns an 85% equity interest, and Mr. Guang Li owns a 15% equity interest in ZHLDBJ. ZHLD has entrusted Mr. Xiqun Yu to hold 20% of its equity interest of ZHLDBJ on its behalf. ZHLDBJ will be involved in the vocational training business, which includes IT engineering, and accounting training. In February 2010, the Company, through ZHLD, incorporated a new company in the PRC, Beijing New Shifan Education & Technology Co., Ltd. ("New Shifan") with a registered capital of RMB1.95 million (approximately \$291,132). ZHLD owned a 65% equity interest in New Shifan and the other equity holders together owned a 35% equity interest in New Shifan. In September 2011, New Shifan changed its name to Beijing Hua Yu Pin Xue Education Technology Co., Ltd ("HYPX"). In October 2011, ZHLD took over the 35% equity interest from the other equity holders of HYPX without any consideration, and entrusted Mr. Xiqun Yu to hold the 35% equity interest on behalf of ZHLD. In November 2011, HYPX increased its share capital to RMB2 million (approximately \$298,567). In January 2012, due to changes in government regulations, the Company authorized Mr. Yu to hold the 100% equity interest on behalf of ZHLD. In 2012, HYPX established a wholly owned school - Beijing Xicheng District Hua Yu Pin Xue Training School, and together with a previously established wholly owned subsidiary of the Company - Beijing Shifanxuezhitang Information Science Institute, established the Company's new brand image and reputation in several districts in Beijing. In 2015, HYPX established another two wholly owned school – Beijing Dongcheng District Hua Yu Pin Xue Training School and Beijing Haidian District Pinxuetang Training School. HYPX focuses on expansion of our training centers in Beijing, as well as developing extensive marketing strategy to establish new markets in other main cities.

On March 4, 2011, the Company entered into a management agreement with Nanchang Institute of Technology (“NIT”), a vocational training institution based in Nanchang, PRC. Pursuant to the agreement, the Company would assist in managing the daily operations of NIT for ten years for an annual management fee of RMB 10 million (approximately \$1,461,347). The management fee was payable on a quarterly basis and in the event of late payment, a late fee would be imposed. Additionally, a liquidated damage of RMB 50 million (approximately \$7,935,122) would be paid by any party that defaulted on the agreement.

In connection with the management agreement, the Company entered in to a loan agreement, pursuant to which the Company loaned NIT RMB 50 million (approximately \$7,935,122) to build training facilities and NIT would repay the RMB 50 million (approximately \$7,935,112) in ten years from the date NIT received the principal. The loan had an annual interest rate of 20% and the Company would waive the interest if NIT made all payments under the management agreement in a timely manner. We received 20% annual interest income due each quarter, therefore, the management fee was waived. The assets of certain guarantors secured the loan. On March 29, 2013, NIT repaid the loan principal of RMB50 million and accrued interests and the loan agreement was terminated. On the same day, the management agreement with NIT was also terminated.

On February 25, 2011, the Company entered into a share transfer agreement with the shareholder of Harbin Tianlang Culture and Education School (“Tianlang”), a tutoring school with 5,000 students, based in Harbin, PRC. Pursuant to the share transfer agreement, the Company purchased 60% of the equity interests of Tianlang for RMB 35 million (approximately \$5.3 million). The shareholder and the Company also provided RMB 2 million (approximately \$0.3 million) and RMB 3 million (approximately \$0.5 million) as working capital for Tianlang, respectively. Tianlang had established a new board of directors with five directors, of which three directors were appointed by the Company and two directors were appointed by the shareholder. The acquisition of Tianlang was completed in April 2011. We are currently co-managing Tianlang with the previous majority owner. The Company and the previous majority owner will be entitled to 60% and 40%, respectively, of the profits of Tianlang. The Company did not foresee that the investment cost in Tianlang is recoverable in the near future. As a result, the Company conducted impairment test by the end of 2014 and June 2015, and the impairment loss of \$3,254,308 and \$625,922 has been included in this financial statement.

On May 31, 2011, the Company entered into share transfer agreements with the shareholders (the “Shareholders”) of Changchun City Chaoyang District Nuoya Foreign Languages School (“Changchun Nuoya”) and Harbin City Nangang District Nuoya Foreign Languages School (“Harbin Nuoya”), two foreign language schools based in the PRC.

Pursuant to the agreements, the Company purchased 100% of the two schools for an aggregate of RMB 16 million (approximately \$2.5 million), and all consideration had been paid up. The Shareholders’ obligations under the agreements are guaranteed by a guarantor who will be jointly and severally liable in the event of a breach by the Shareholders. The acquisition of Changchun Nuoya and Harbin Nuoya was completed by the end of May 2011 and their financial statements had been consolidated with the Company’s financial statements since May 2011. The Company did not foresee that the investment cost in Harbin Nuoya and Changchun Nuoya is recoverable in the near future. As a result, the Company fully impaired its investment in the two schools. As there is little demand for

non-English classes at the time being, the Company has suspended the operation of both schools.

In June 2012, the Company, through ZHLD, incorporated a new company in the PRC, Harbin Zhong He Li Da Information Technology Co., Ltd. (“ZHL DIT”) with a registered capital of RMB2 million. Mr. Yu has been entrusted to hold the 100% equity interest on behalf of ZHLD. ZHL DIT was established to initiate and design a platform for online education programs, and provide this effective and efficient communication service to all the teachers and students.

2 Basis of Preparation of Financial Statements

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”). The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation. The portion of the income applicable to noncontrolling interests in subsidiaries undertakings is reflected in the consolidated statement of operations.

The consolidated interim financial information as of June 30, 2015 and for the three and six month periods ended June 30, 2015 and 2014 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have not been included. The consolidated interim financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2014, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of June 30, 2015, its consolidated results of operations and cash flows for the three and six month periods ended June 30, 2015 and 2014, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

3. Summary of Significant Accounting Policies

Use of estimates - The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of net sales and expenses during the reported periods.

Significant estimates include values, classification, useful lives assigned to and impairment of acquired intangible assets, the useful lives and impairment of property and equipment, collectability of accounts receivable, reserves for allowances and stock option valuation. Actual results may differ from these estimates.

Cash and cash equivalents - The Company considers all highly liquid debt instruments purchased with a maturity period of three months or less to be cash or cash equivalents. The carrying amounts reported in the accompanying unaudited condensed consolidated balance sheets for cash and cash equivalents approximate their fair value.